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Business in Brief

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THE CHASE MANHATTAN BANK

The recovery in business activity is continuing. The slow-down in auto production in September and October held back the rate of advance temporarily. Now auto production is rolling again as the changeover to the 1959 models has been completed and labor difficulties have been smoothed out.

Meantime, all of the other nineteen industrial groups in the Federal Reserve Index have moved up from the April low. Output in most nondurable lines is as high or higher than in the peak month last year. Durables production has been on the upgrade but is still some distance below the previous high. This sort of uneven pattern is characteristic of most periods of business recovery.

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How long is the recovery period likely to last? Experience offers one guide. National Bureau studies show that the expansion phase of the cycle has lasted an average of 30 months in the 24 recorded cycles. The shortest expansion was 10 months in 1921. Only 5 have lasted less than 20 months.

Whether the current expansion will match or exceed the past average depends on the character of the recovery. A balanced recovery could carry on for some time. One that generated excesses in the form of inflation, speculation or over-expansion could prove abortive.

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So far the recovery period shows both plusses and minusses. On the positive side, productivity has been rising rapidly, Federal Reserve policy has shifted towards restraint, prices have leveled off and the general expansion appears so far to be broadly-based and well-balanced.

Yet there are disturbing signs that the recovery could generate renewed inflationary problems. In real terms, the economy has enough excess capacity to support a considerable advance before upward pressure on prices develops. However, the prevailing psychology—particularly in financial markets—is dominated by apprehension of inflation.

Expectations of inflation have been fostered by the Federal deficit and the advance of wage rates in a recession. Moreover, the fact that the recession was moderate and short-lived has been interpreted as a sign that deflation is no longer a source of concern.

Are fears of inflation justified? Much depends on the behavior of productivity in the period ahead. Productivity has risen sharply in recent months. Preliminary estimates point to a gain of 4% for the six months April to October, a rapid rise even for a recovery period.

The significance of productivity is apparent from a review of past trends. The historic rate of advance in productivity has been 2% per year, and this increase has been made possible by an average investment in new and more efficient plant and equipment equal to 11% of total national output. We have produced more in each man-hour of work, not by exerting greater effort, but by using more productive equipment.

From 1947 to 1955 productivity rose at an average annual rate of more than 3%. However, the rate of gain slowed in 1956 and 1957 to little more than 1% per year. This lag helped to explain:

¶ The appearance of excess capacity—production rose only 3% while capacity expanded 11%;

¶ The rise in prices—wages rose 11% while output per man-hour increased only 2½% and prices were pushed up 7½%.

In the past year many of the problems that held back the increase in efficiency in 1956 and 1957 have been overcome. New plant and equipment installed in previous years has been put to more effective use and obsolete units retired. Business has been pruning costs aggressively.

However, even if the advance in productivity matches the average of 3% per year achieved in 1947-55, containing inflationary pressures could pose difficult problems. The average increase in wage rates in recent years has run to more than 5%, and it may exceed 3% in the recession year of 1958.

While continued recovery would add to tax receipts, the present prospect is for some further Federal deficit in fiscal 1960 and no more than a small surplus in fiscal 1961. This will place an additional burden on credit controls.

The maintenance of economic growth without inflation is never an easy process. It promises to be particularly difficult as we move through 1959. Yet, if the nation is to achieve the economic growth of which it is capable, it must demonstrate the maturity necessary to support effective measures to contain inflation.

THE DEBT MANAGEMENT PROBLEM

Can the Treasury successfully sell large amounts of long-term debt without interfering with the business recovery? Will short-term financing necessitate an inflationary increase in the money supply? Questions like these are the subject of intensive debate in financial circles as the Treasury proceeds with its task of financing a record peacetime deficit—officially estimated at $12 billion. The solutions found will have a significant bearing on our ability to achieve growth without inflation.

POSTWAR SHIFTS IN PUBLIC DEBT OWNERSHIP

	June 30, 1947	June 30, 1958	% Change
	Billion	Dollars	
Commercial Banks	70.0	64.6	— 7.7
Individuals	66.6	66.0	— .9
Savings Banks and Insurance Companies	36.7	19.1	—48.0
Corporations	13.7	13.3	— 2.9
State and Local Governments	7.1	16.9	138.0
All Other	9.6	15.2	58.3
Total	203.7	195.1	— 4.2
Federal Reserve and Treasury	54.7	81.3	48.6
Total Public Debt	258.4	276.4	7.0

Data: Treasury Dept.

The Current Setting

In the five months since the start of the current fiscal year on July 1 the public debt has increased by $7 billion, reaching a new peak of $283 billion. A further rise appears certain. However, finding buyers for new debt is only a part of the Treasury's problem. During the coming year, upwards of $50 billion of maturing marketable debt and savings bonds will need to be refinanced.

Thus far, the Treasury has relied on short-term issues in meeting the current deficit. Concern that financing of that type would lead to an inflationary rise in bank credit has not yet been borne out. In fact, prior to the Treasury's recent cash offering of $3 billion Tax Anticipation Bills in mid-November, weekly reporting member banks actually held about $1 billion fewer Governments than at the start of the fiscal year. That reduction took place despite the net sale of $5½ billion new marketable securities by the Treasury over the period.

Non-bank absorption of the new Treasury debt was made possible largely by a rapid rebuilding of corporate liquidity during the early stages of the business recovery. With inventories still declining, and with capital spending at a low ebb, corporate needs for funds have declined. At the same time, rising levels of sales and profits have generated an increasing volume of cash—much of which has found its way into short-term Governments.

These trends can not persist indefinitely. If levels of business activity are to continue rising, corporations at some point will need more funds to meet inventory and other working capital needs, and later on for new plant and equipment. Then, they will no longer provide so ready a market for new Treasury debt, and their own demands for credit may more actively compete with those of the Government.

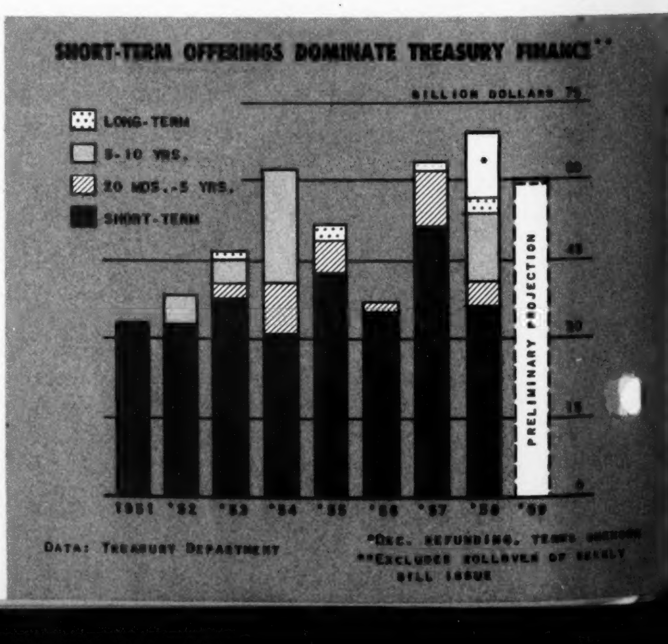
In a sense, recent developments have enabled the Treasury to postpone some fundamental decisions concerning "permanent" financing of the deficit. The respite has been most welcome in view of the severe decline in bond prices last summer, and its aftermath of market caution and uncertainty. But the result has been a piling up of nearby maturities. Ultimately, the Treasury must face up to the fundamental dilemma of competing actively with other borrowers for a limited supply of savings, or resorting to commercial bank financing.

Theory versus Practice

Many monetary theorists have argued that Treasury debt management can play a positive role in reinforcing counter-cyclical credit policies.

- These theorists suggest that, during periods of rising business activity and inflationary pressures, the Treasury should concentrate upon issuing longer-term bonds, and should avoid sales to commercial banks. The object would be to curtail the liquidity of the economy and divert loanable funds from other long-term borrowers, thus acting as a restraint on private investment and spending.

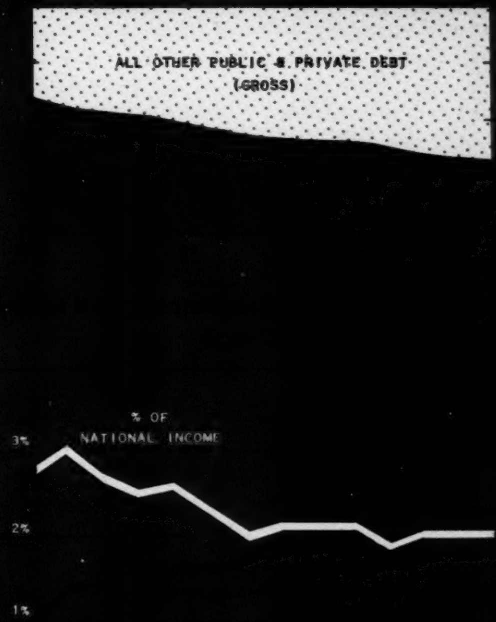
- Conversely, during periods of recession, sale of short Treasury debt, highly liquid and appropriate for commercial bank investment, has been advocated. This short debt would then provide a basis for monetary expansion during a period when other credit demands are likely to be declining, and limit the Treasury's competition with other potential borrowers.



Recent experience has led many observers to question the practicality of these theoretical precepts. Stepping up sales of long bonds sharply during boom periods, just when competition for available funds is likely to be most intense, runs the risk of disturbing the capital markets to an extent that produces undesirable, and essentially unpredictable, side effects. The impact is likely to be greatest on homebuilders and state and local Governments, tending to run counter to what might be other Government policies designed to promote investment in those areas. And borrowing long-term at the high interest rates prevailing during boom periods entails larger service charges on the public debt over the future.

Moreover, excessive liquidity built up during recessions can not easily be squeezed out of the financial system as business recovers. Thus, widespread holdings of short Treasury debt may hamper the effectiveness of restrictive credit policies during subsequent recovery periods.

These latter considerations have apparently been persuasive to the Treasury during recent years. As a result, efforts to lengthen the debt have been confined chiefly to the recession periods of 1953-54 and 1957-58. During other periods, short-term issues have provided the principal financing medium, and the full burden of restraining monetary overexpansion and private borrowing during boom periods has fallen on the Federal Reserve. One consequence has been a shortening of the structure of the Federal debt over the past decade.



A Middle Course

In view of the practical difficulties of counter-cyclical debt management, a considerable body of responsible opinion has veered toward the view that the Treasury might best discharge its broad public responsiblities by pursuing relatively neutral policies with respect to the business cycle. These policies would be designed to contribute toward a broad and responsive Government securities market in all sectors, and to minimize potential conflicts with the conduct of credit policy.

Such objectives would entail a continuous effort to distribute the public debt more widely among savings institutions and individuals. Over time, efforts would be made to reduce the current preponderance of short-debt, perhaps by pre-maturity refunding of notes or bonds, before they too become short-term issues. To avoid interference with the day-to-day conduct of Federal Reserve policy, refundings of short-debt would be reduced in numbers, and spaced at relatively even intervals through the year. Long-term bonds would be floated as a matter of course from year to year, but in moderate amounts.

A Joint Responsibility

There is no easy solution to the Treasury's current problems. Nor can the solution rest with the Treasury alone.

Progress toward restructuring the debt is inhibited by the necessity—imposed by the budgetary deficit—of simultaneously finding buyers for a large amount of new debt. The costs of long-term Treasury borrowing, in terms of increased interest charges and its impact on other borrowers, must be recognized and willingly assumed. Other Governmental financing must be coordinated with the Treasury's needs.

In the end, the active cooperation of the private financial community will be essential to the success of any program for reconstructing the debt. That implies, however, a corresponding obligation on the part of the Treasury to bear in mind, when shaping debt management decisions, the direct responsibilities of private institutions to their own customers.

A GOOD YEAR ON THE FARMS

Nature and the government combined to make 1958 a good year for the farmers. Cash receipts from farm marketings may well approach 1951's record $33 billion, while net farm income, after allowing for higher production expenses, may be up one-fifth from last year.

Still, this good showing should be eyed with caution: it has not occurred because of a long run solution to the farm problem; rather, it came about because of a fortuitous combination of production trends and government policies.

Bumper Crops

In the first nine months of 1958, crop receipts totaled $9 billion—up 13% from a year ago. Favorable weather and amazing strides in productivity lifted per acre yields of major crops by 14% over last year's record level. Thus total crop production is estimated at 11% above the previous high, and this output has been produced on the fewest acres under cultivation since the first World War.

Increases in supply of this magnitude ordinarily would exert major downward pressure on prices. However, the federal farm program helps support prices. In spite of a 53% increase in wheat output and a 20% rise in soybean production, the price of food grains fell only 8% and feed grains 9%.

With the price declines in grains held to reasonable levels, record crop marketings raised farm income. Nevertheless, in the longer run, the farm problem has been aggravated. This year's bountiful harvests mean a build-up in surpluses and an increase in the government's $7 billion investment in price-supported commodities.

Lower Meat Supplies

Producers of livestock have also enjoyed higher incomes, but for different reasons. The volume of marketings dipped below last year and prices received by farmers jumped sharply. Marketing receipts from livestock and products totaled $13.8 billion in the first 9 months of 1958—up 10% from the 1957 level. Still, the future holds some uncertainties.

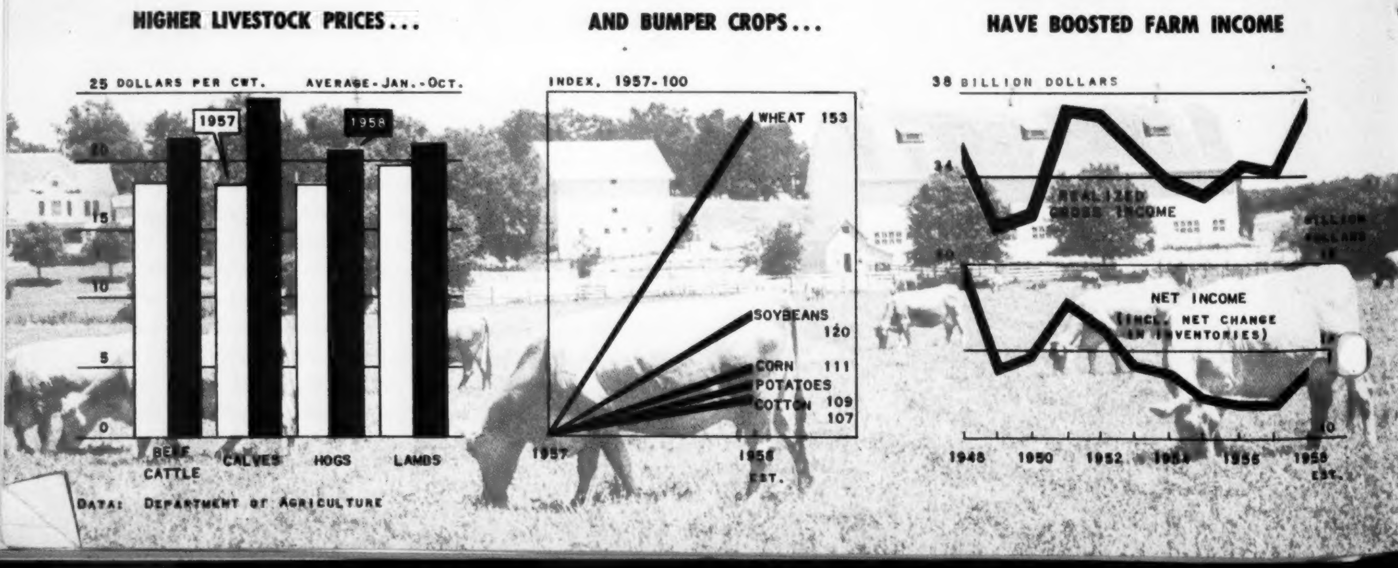
The familiar corn-hog cycle is in full swing. Cheap plentiful feed encouraged larger pig crops and increased pork supplies are starting to come onto the market. Prices started to fall last June and are expected to drop further next year. Hog production will then be curtailed as feed costs rise in relation to the lower value of hogs, so that in a few years hog prices could again be on the upswing.

Developments in the cattle market are more complicated. Non-dairy cattle are generally sold to feeders to be fattened for slaughter or to breeders to enlarge herds. With consumer demand for beef strong and the supply of cattle limited because of reductions in herds since 1956, cattle prices have been rising since 1957. Abundant feed supplies and excellent grazing conditions seem to offer a made-to-order situation for cattlemen.

Nevertheless, the cattle market is uneasy. To take advantage of low feed costs and high slaughter prices, feeders have bid up the prices of cattle for feeding. The margin of return has been reduced and a rise in feeding costs or drop in slaughter price could wipe out any profit. Thus, price-cost relationships are currently a cause of considerable concern to cattle producers.

The Farm Problem

Notwithstanding uncertainties in the livestock picture, the major farm problem continues to center around rising crop surpluses. This year government outlays for crop support, soil bank and similar purposes will total almost $6½ billion—an increase of nearly $2 billion from 1957. With surpluses mounting and costs rising, the search for a reasonable solution to the farm problem should again stand high up on the Congressional priority list for 1959.

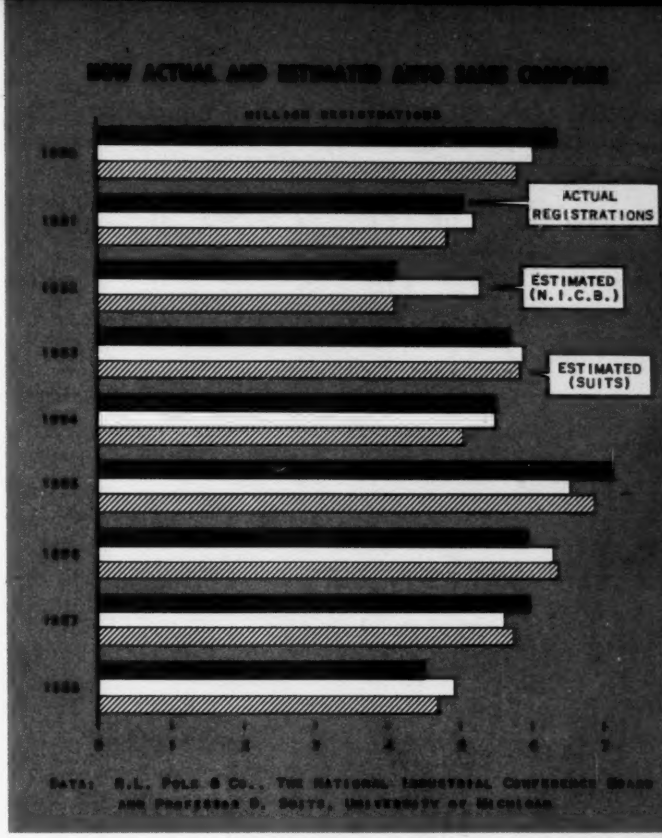


THE AUTOMOBILE PICTURE

How will the new auto models be received? That's always a key question at this season of the year. It's especially important now. A good year for autos—6 million or more—would support a vigorous expansion of the entire economy. A disappointing year—less than 5½ million—would place a drag on the general recovery.

Industry officials and business economists have issued predictions of 1959 sales ranging from 5½ to 6½ million passenger cars. What accounts for the fact that there is a 1 million spread in such estimates? What are the factors that forecasters consider in making projections of new car sales?

There are two main reasons why observers take varying views of the auto outlook. No one can predict how the public will react to the styling of the new models. Then, opinions differ as to the future course of the basic economic factors that affect auto demand.



Economic Factors

Economists generally agree that the long-term trend of auto demand is influenced by such basic factors as population, the growth of consumer income and shifts in income distribution. Thus, the striking increase in the number of 2-car families from 2 million in 1949 to 7.3 million in early 1958 reflects not only the rise in income over the years but also its broader distribution.

In addition, the number of cars on the road, the age distribution of the stock of cars, and the scrappage rate are underlying factors in the auto market. Scrappage is now estimated at around 4½ million a year.

Short-Term Influences

While most of the long-term factors would appear to be running in a favorable direction for sales of the 1959 models, experience shows that consumer income and auto prices are the most important causes of year-to-year fluctuations in sales. Various studies have shown that a 1% increase in personal income after taxes leads to a 2-4% increase in sales, whereas a 1% increase in auto prices cuts sales by from 0.6% to 1.5%.

Shifts in consumer credit terms have also been important. The sharp lengthening in auto credit contracts in 1955 helps explain the rapid rise in sales that took place that year. Most of these cars have now been paid for in full, a favorable factor for this year's sales.

Techniques of Projecting Sales

In attempting to make estimates of new car sales, technicians have studied past relationships among the various factors set forth above and have sought to work out procedures that might be useful in forecasting.

The National Industrial Conference Board, for example, relates new car sales to the number of spending units, the level of income, and the change in income from the preceding year. If income should rise in 1959 at the same rate as it did after the 1954 recession, this equation would yield an estimate of approximately 6.6 million for 1959 sales.

The U.S. Department of Commerce uses a method which relates new car sales to households, income, relative auto prices, and scrappage. Assuming a 2 to 3% increase in auto prices, this equation would project 1959 sales of 5.5 million cars.

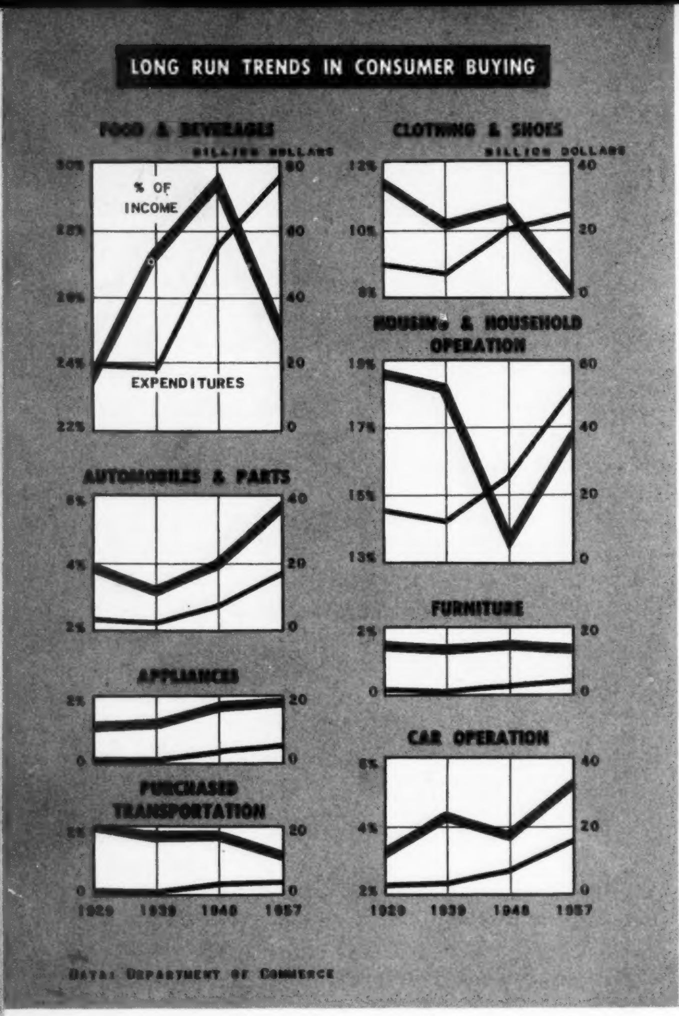
Professor Suits of the University of Michigan also brings in credit conditions. His formulation makes the demand for new cars a function of income, the stock of cars and the average monthly payment. A projection for 1959 based on this equation would fall within the 5.5 to 6.5 million range.

How practical have these methods proved as a forecasting tool? In virtually all cases, they have been correct as to direction of the change from one year to the next. They have, however, tended to underestimate the degree of fluctuation, particularly in years of recovery or recession, as 1955 or 1958.

For the year ahead, all of the methods yield projections of a substantial increase in auto sales from this year's 4¼ million. Yet the imponderables in the picture—consumer reaction to styling and consumer decisions as to whether this is a good time to buy autos—will determine the extent of the increase.

The sales record in the next few months should show whether actual results for the model year will fall near the low end of the estimates—5½ million or less—or reach the high range of 6½ million. Experience to date would point to a good, but not a record, year for autos.

SHIFTS IN CONS



The basic strength of consumer markets has been one of the noteworthy features of the current recession. Despite the rapid drop in production and employment, total consumer spending fell less than 1% during the declining phase of the recession. Then, starting with April consumption increased—and expenditures for items other than autos were actually 3% above the pre-recession peak during the third quarter.

The behavior of consumption reflects the changes in income after taxes. The "built-in" stabilizers (unemployment insurance, old age pensions and lower tax liabilities) offset half of the decline in wages, salaries and business income. Disposable income declined only 1% in face of a 13% drop in industrial production. And income is now almost 2% above the previous high reached last year.

Spending Shifts

However, the pattern of buying has shifted. Sales of durable goods dropped 12%, with a 22% decline in autos. Apparel sales also dropped. In contrast, people have been spending more for other nondurable goods and services.

This shift in the pattern of buying is typical of past recessions. Whenever people are concerned about the security of their jobs and their incomes, they cut down purchases of durables. When incomes increase during recovery, sales of autos and other durables rise sharply.

However, some observers have suggested that there may be new forces at work that could lead to a basic shift in the pattern of consumption. They maintain that the consumer is losing his enthusiasm for durable goods and argue that less will be spent for autos, appliances, furniture and the like to make way for greater spending for education, travel and services.

In short, the question is whether people's standards of values are changing. Only time will provide the full answer. But an examination of past trends may help provide perspective.

Long Term Trends

Despite the striking changes in our society during the past three decades, the main features of consumer budgets have undergone surprisingly little alteration. The major triad of essentials—food, clothing and shelter—accounted for 50% of consumer expenditures in 1957 as compared with 53% in 1929.

However, there have been major shifts in the pattern of spending within these groups. For instance:

- An increasing share of the food dollar is spent for easy-to-prepare foods and for foods that make up a better diet. Almost 25% of consumer expenditures now go for food—it has been estimated that only 16% of consumer expenditures would be needed to purchase a pre-war diet for our present population.
- The share of consumer budgets allocated to clothing has declined almost 30% since 1929—but casual clothing in the form of sports jackets, slacks, skirts and the like have scored good gains at the expense of more traditional apparel.

Autos Take A Larger Share

By the same token, there has been remarkably little change over the long-term in the proportion of expenditures going for durable goods and for services, though there have been noteworthy shifts within each category.

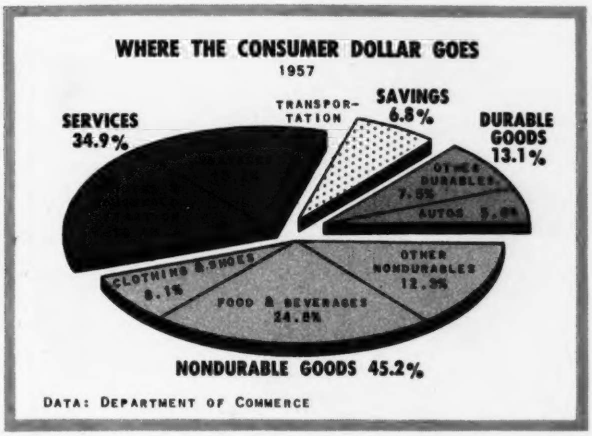
Within durable goods, the major shift has been toward automobiles. The auto industry's share of the consumer dollar was 3.85% in 1929, 3.12% in 1939 and 5.6% in 1957. The 1957 figure was below the highs reached in 1950 and 1955. Yet it is clear that up to the onset of the current recession consumers had been spending more of their income on autos than in pre-war days.

The share of outlays for services has also increased in recent years—from 30% of the total in 1947 to 35% in 1957. Yet the share in 1929 was almost 39%. Services were curtailed during wartime, so much of the increase since then represents a catching up.

NS UMER MARKETS

Underlying Factors

These changes in consumer buying patterns reflect some of the fundamental influences in our economy—higher incomes, the expansion of the middle income market, a larger population with a different age structure, more leisure, the move to the suburbs, and new products. And trends in these basic factors will continue to shape consumer markets in the period ahead.



In 1929, the average family had an after-tax income of $3,910 in 1957 dollars. Now income is up 40% to $5,480. This works out to a growth of about 1½% a year.

Higher incomes have not only increased the amount people can afford to spend. They also have enabled the consumer to be more selective. More "discretionary income"—what remains after all necessities have been paid for—is available. It is this optional amount and its flexibility which explains much of the shift in the pattern of consumer expenditures.

The Middle Income Market

Not only has income been rising—its distribution has changed. Precise figures for 1929 are not available. But in the past decade alone the middle income $4,000 to $15,000 brackets increased from 22 million families to 32 million. That's a jump from 48% to 59% of all families. This "leveling up" process has created a mass market in place of the narrower markets of the 1920's.

Old People, Young People

Another significant influence in the past—and perhaps the most important one in the next few years—has been the growth and changing age structure of the population. There are now more than 175 million Americans, up from 122 million in 1929. And a new consumer is added at the rate of one every 11 seconds!

It takes only a moment's thought to realize that today differences in budgets are also due to a family's "place in the life cycle." For example, right after the war, marriage and birth rates soared, and the demand for furniture, appliances, homes and baby things boomed. In the next few years, these post-war babies will be adding to the teenage population at the rate of a million a year.

And the impact will be most striking. Whereas a 10-year-old eats half as much as an adult, an 18-year-old eats 20% more. Whereas a child can get along with informal clothing, a teenager is more clothes-conscious. Nearly every product will be affected by the growing teenage market.

How Will the Trends Add Up?

Yet significant as they are, these statistics do not tell us the whole story. True, more people have more money to spend. How they spend it is influenced by their income and their stage in the life cycle. But other desires and attitudes are important in filling out the picture.

Many people want a home of their own. Since 1929, the suburban population has grown at more than twice the rate of the total population—creating a demand for homes, lawnmowers, automobiles. Many people want more leisure even at the expense of a slower growth in incomes. And so work weeks have been shortened, vacations have lengthened, and people retire earlier. Increased leisure has added to demand for TV sets, records, do-it-yourself kits and sports equipment.

All in all, it would appear that consumer markets are likely to display greater shifts in the future than in the past. If we can continue to keep our economy growing, the broadening and widening of consumer markets should be a major feature of the process of economic growth.

Such trends would not necessarily imply major or abrupt changes in the past pattern of consumer expenditures—the lesson of the past is that changes come slowly. Yet the trends in population, income, and consumer tastes would seem to point to increased emphasis on a continued upgrading in markets for many products and to increasing expenditures for education, recreation, culture and travel. In short, the competition between goods and services in consumer markets may become increasingly intense.